

TELECOMMUNICATIONS

The competitive environment of Japan's telecom sector has steadily evolved over the past several years as the Japanese Government's efforts to promote policy and regulatory reform have begun to yield some positive results. This is evident in the roll-out of numerous advanced telecommunications technologies, including the spreading popularity of services such as Digital Subscriber Line (DSL) and Fiber-to-the-Home (FTTH). Japan also remains on the forefront of wireless Internet services, identified as a key area in both the IT Strategic Headquarters' recently finalized "e-Japan Strategy II," and the Telecommunications Council's July 2003 "Radio Policy Vision." Revisions to the Telecommunications Business Law (TBL), approved by the Diet in July 2003, contributed to the momentum by deregulating competing carriers while upholding dominant carrier regulation.

The "e-Japan Strategy II" is based on the assumption that Japan's policy focus should shift from competition at the infrastructure level to competition in services and applications. In both areas, however, bold reforms are still needed to challenge the status quo, facilitate a transition to advanced networks and services, allow market forces to be the primary agent of change, and sweep away obsolete regulations that have hindered the development of a competitive environment. While recognizing the structural changes currently underway in Japan that have been stimulated by reform and technological innovation, the United States urges Japan in this year's recommendations to examine more closely how it maintains the principles of non-discriminatory treatment, transparency, regulatory independence, and accountability.

Building on the progress achieved in the previous year, the United States suggests that the Telecommunications Working Group continue to invite experts from government and the private sector to provide their perspectives on new and mutually important issues, such as advanced wireless technologies and services. In addition, the United States recommends that Japan implement the following reforms in CY2004:

SUMMARY OF RECOMMENDATIONS

- **Deregulation of Non-Dominant Carriers:** Link regulatory obligations to market power and eliminate or reduce filing and reporting requirements for carriers without market power.
- **Regulatory Independence:** Take steps to transfer regulatory functions to an independent agency not under ministerial authority, and end Ministry of Public Management, Home Affairs, Posts and Telecommunications (MPHPT) control over NTT's business decisions.
- **Transparency and Accountability:** Increase public participation in MPHPT's regulatory and policy decisions, and adopt measures to facilitate reconsideration and judicial review of MPHPT's regulatory decisions.
- **Strengthening of Competition Safeguards:** Reinforce dominant carrier safeguards to prevent abuses by carriers with market power.
- **Wireline Interconnection:** Address structural flaws in the 2003-2004 interconnection rate methodology through a transparent and objective review, with the aim of encouraging cost-oriented and reasonable interconnection rates that promote efficient competition.
- **Mobile Termination Rates:** Investigate if rates for termination to the NTT DoCoMo network are set at reasonable, competitive levels, and ensure competitive neutrality in retail rate setting.

TELECOMMUNICATIONS

- I. Eliminating Unnecessary Rules, Strengthening Regulatory Independence, and Promoting Greater Transparency.** Based on reforms initiated last year, the Ministry of Public Management, Home Affairs, Posts and Telecommunications (MPHPT) has established a legal basis for eliminating a range of unnecessary regulations that can reduce the cost of doing business and allow carriers to more quickly provide the services that customers want. Specific steps MPHPT could take to implement this deregulatory mandate include:

- A. Deregulating Competitive Carriers. The United States recommends that for non-dominant carriers in competitive markets, MPHPT:

1. Institute class licenses, which do not require any application by telecommunications service providers;
2. Replace tariff filing requirements with Internet-based public notifications, eliminating MPHPT *ex-ante* procedures;
3. Eliminate all filing and notification requirements for contract-based services;
4. For interconnection, entrustment, and other business arrangements between competitive carriers, eliminate all filing and notification requirements;
5. For initial licensing requirements for wireline service providers, eliminate requirements to provide detailed cost justifications, financial assumptions, and network planning information beyond the general scope of services and description of network;
6. For network expansion for wireline service providers, eliminate approval processes, and limit any notification requirements to brief general descriptions; and
7. Permit carriers to acquire and use wavelength-based IRU's (indefeasible rights of use) for the provision of services.

- B. Promoting Transparency and Strengthening Regulatory Independence. MPHPT and its predecessor, MPT, have long had difficulty shielding the regulatory decision-making process from partisan influences. Recent decisions that have benefited larger companies with histories of government ties, at the expense of new entrants, underscore the critical need for measures to bolster regulatory independence and accountability. To foster regulatory independence and transparency the United States urges Japan to:

1. Develop a plan for removing regulatory functions outside the purview of a ministerial agency subject to direct political control, to a fully independent organization;
2. Eliminate any requirement that the Japanese Government own a specified amount of NTT shares and that foreign shareholding or a management role be restricted;
3. Eliminate ministerial interference in management operations of NTT, including business plans and personnel decisions;
4. Establish and exercise meaningful sanction authority by the regulator (imposition of fines, payments of damages, license restrictions) to punish anti-competitive behavior;
5. Take interim steps towards achieving these goals that would include:
 - a. Implementing measures to strengthen the operation, effectiveness, and purview of Japan's Dispute Resolution Commission, including steps to maximize transparency in dispute settlement actions;
 - b. Publishing criteria to ensure that officials with any financial ties to specific telecommunications carriers play no role in decisions affecting the competitive position of such carriers; and
 - c. Requiring senior-level MPHPT officials with any role in regulatory matters to file financial affidavits documenting their relationships with firms under their regulatory purview.
6. To foster greater regulatory accountability, take concrete steps to facilitate reconsideration and judicial review of regulatory decisions, and ensure that the regulator and the courts have the resources to address such issues effectively within a reasonable timeframe. Specifically, this should include:
 - a. Adopting and publishing transparent procedures to ensure that any person aggrieved by a determination or decision of the regulator be able to petition for reconsideration of that determination or decision;
 - b. Adopting and publishing transparent procedures to ensure that any person aggrieved by a determination or decision of the regulator may obtain judicial review of such determination or decision;
 - c. Adopting and publishing transparent procedures to ensure that a full, public record supporting decisions and determinations is

available, and that special interests are not accorded privileged access to the regulatory process; and

- d. Opening the selection process for MPHPT-sponsored study groups such that any interested stakeholders are given the opportunity to participate.

II. Network Access and Promotion of Competition. Competitors' access to bottleneck facilities remains essential to promote both facilities-based and service-based competition, which are key Japanese Government goals. In accordance with the July 2003 recommendations of its "Study Group on Methods for Evaluating Competition in the Telecommunications Field as IP Evolves," MPHPT has recognized the importance of reviewing pro-competitive policies in a changing market. With due consideration to this context, the United States will continue to identify areas in which it believes Japan can take concrete measures to improve the competitive environment for telecommunications. Relevant issues include:

- A. Dominant Carrier Regulation and Competition Safeguards. The United States recommends that Japan ensure that regulations and ministerial ordinances under the revised Telecommunications Business Law retain obligations specific to carriers with a dominant position in Japan's market and give the appropriate entity the authority to enforce these obligations. In particular, the United States urges Japan to:
 1. Ensure in law and/or regulation non-discriminatory cost-based access to poles, ducts, conduits, and rights of way and provide transparent pricing methodology for such access;
 2. Establish methods for evaluating pricing abuses by dominant suppliers (e.g. imputation tests) for voice as well as data services;
 3. In the annual review of whether NTT East and West are complying with the parameters governing expansion into new lines of businesses, publish quantitative data relating to network access and treatment accorded competitors;
 4. Institute transparent means, based on information to be made publicly available, for evaluating whether leased lines used by competitors are offered at reasonable, competitive rates;
 5. Consider rules (e.g. separate affiliate transaction rules) to ensure that a dominant supplier does not use revenues from a regulated service to subsidize a non-regulated service in an anticompetitive manner;
 6. Develop competition-related performance metrics, including reporting requirements, and financial penalties for missing such metrics. Such

metrics should ensure that a dominant carrier treats competitors no less favorably than it treats itself or its affiliates in matters such as provisioning, quality of service, and repair and maintenance of all network services and facilities needed by competitors; and

7. Ensure that dominant carriers seeking to expand the scope of their services outside their traditional monopoly services be subject to appropriate safeguards to ensure that dominant position in one market is not leveraged with anticompetitive effects.

B. Wireline Interconnection. MPHPT's recent changes in implementation of its LRIC methodology (as a matter of sovereign choice) raises the prospect of major increases in interconnection rates and serious erosion in new entrants' ability to compete against NTT companies. Reforming this rate-setting process to ensure efficient competition is thus a key priority for all competitors, foreign and Japanese alike. Specifically, the United States urges MPHPT to:

1. Undertake a public review, open to the comments and views of all interested stakeholders, of interconnection rates and structure, to determine how to remove non-traffic sensitive costs from metered interconnection rates, starting in FY2003;
2. Initiate, and conclude before any new system is introduced, an objective evaluation of NTT East's and West's ability to absorb non-traffic sensitive costs out of existing monthly rates;
3. Require NTT East and West to document, in a transparent, publically verifiable manner:
 - a. Precisely which costs are currently recovered from monthly subscriber line charges;
 - b. How such costs are identified and allocated between different services (e.g. ISDN, DSL, leased lines etc.); and
 - c. The assumptions behind such cost recovery, including *inter alia* cost recovery already achieved through initial subscriber line charges (*kanyu kenri* or *shisetsu secchi futankin*), depreciation rates and methodologies used, and allowable profit margins.
4. If traffic data indicate that rates should be adjusted, prior to any such adjustment, require that:
 - a. Such data be independently audited by the regulator and that measurement methodologies be publicly documented, subject to notice and comment;

- b. In conjunction with changes to traffic data inputs, the opportunity to adjust other input data such as equipment pricing also be provided and any changes incorporated prior to any such changes; and
 - c. Any network cost calculations affected by changes such as a shift to IP telephony and other advanced technological services take into account additional revenue NTT earns from network elements supporting the growth of such new services.
- 5. Require NTT East and West to each set a cost-oriented interconnection rate, taking into account differing costs of the respective regions; and, as necessary, permit differential interconnection rates between the regional carriers, taking into account dangers of (and methods to prevent) anti-competitive price squeezes;
- 6. Consider transitioning to a bill-and-keep cost-recovery mechanism for a range of network access functions;
- 7. Eliminate the current use of interconnection revenue as a source of cross-subsidization between NTT East and West, and require that any such subsidies be paid out of a competitively neutral universal service fund; and
- 8. Ensure that carriers can request assistance from the Telecommunications Business Dispute Settlement Commission to resolve disputes regarding negotiated interconnection for voice calls carried between analog systems and IP-based networks, as well as between carriers providing IP-based voice telephony, taking into account the market power of dominant carriers.

C. Mobile Termination Rates. The United States urges Japan to:

- 1. In accordance with Japan's Telecommunications Business Law and Japan's 2002 commitment to ensure competitive interconnection rates for dominant wireless networks, institute an objective and transparent means for evaluating whether mobile wireless termination rates are set at cost-oriented levels, and to provide a basis for arbitration if negotiations fail; and
- 2. For wireline carriers seeking to interconnect with mobile operators, institute competitive neutrality by eliminating the default right of mobile carriers setting the retail rate.

D. Non-Discrimination in Service Quality. For facilities where unbundling is required, the United States urges Japan to require NTT East and West to:

1. Include among their interconnection terms and conditions a service level agreements (SLA) similar to those offered to retail customers, specifying the period within which NTT East and West must respond to a disruption or deterioration of service; and
 2. Permit wholesale customers the option of maintaining facilities themselves, subject to reasonable access to such facilities.
- E. Network Channel Terminating Equipment. The Japanese Government is invited to propose options to streamline the 1990 NCTE Agreement, consistent with the goal of ensuring competition in the market for terminal equipment. This should include safeguards against abuse of control over interfaces deployed in the public network by dominant carriers.

III. Measures to Promote Advanced Wireless Technologies and Services. In its “e-Japan Strategy II,” Japan recognized that emerging wireless technologies such as Radio Frequency Identification (RFID) and Wireless Local Area Networks (WLANs) will each play their own particular role in the creation of an “ubiquitous network society.” The Telecommunications Working Group provides a timely opportunity to exchange views on the experience of both countries, identify market-based approaches that contribute to expansion and use of emerging advanced wireless technologies, and facilitate the mutual understanding of regulatory processes in both countries.

- A. Private Sector Input. The United States proposes that, where possible, the Working Group enhance its dialogue by inviting experts from government and the private sector as guest speakers to share their views.
- B. Special Zones. The United States proposes that Japan report on its experience in promoting the use of 5GHz-based Wireless Access systems in Special Zones, and its plans to permit nationwide expansion of such systems, in accordance with the June 2003 World Radiocommunication Conference (WRC) agreement.
- C. Spectrum Use by Unlicensed Low-Power Devices. Consistent with Japan’s policy goal of flexible spectrum allocation, the United States urges the Japanese Government to take steps to ensure the availability of a timely, objective, and transparent process for companies to seek use of spectrum on license-exempt basis for low-power devices, taking into careful consideration existing users in the band. MPHPT should authorize additional tests and/or pilot projects to assess interference if sufficient data is unavailable.